

TESTIMONY BY KANOE MARGOL
INTERIM EXECUTIVE DIRECTOR, EMPLOYEES' RETIREMENT SYSTEM OF THE STATE
OF HAWAII

TO THE HOUSE COMMITTEE ON FINANCE
ON
SENATE BILL NO. 1089, S.D. 1, H. D. 1

APRIL 7, 2015, 2:30 P.M.

RELATING TO THE EMPLOYEES' RETIREMENT SYSTEM

Chair Luke, Vice Chair Nishimoto and Members of the Committee,

The amendments proposed in S.B. 1089, S.D. 1, H.D. 1 will assist the Employees' Retirement System (ERS) in improving and protecting its funded status by properly funding membership service credit for Contributory and Hybrid members.

The Board of Trustees of the ERS strongly supports this proposal.

This bill proposes to amend section 78-25, Hawaii Revised Statutes, to require employees who are receiving workers' compensation benefits to deduct retirement contributions from benefits received. When an employee is approved for workers' compensation wage loss replacement benefits, the employee will be paid up to their full salary for the period of their approved industrial injury leave. In contrast to other types of leaves, the employee will earn full retirement service credit for this period. Contributory and Hybrid employees have the option, but are not required, to deduct retirement contributions from these wage replacement benefits. This proposal will require that contributions are made contemporaneously with the payment of compensation, thereby assuring that the service credit for this period is at least partially funded by the employee.

In addition, S.B. 1089, S.D. 1, H.D. 1 proposes to add a new section to Chapter 88, and amend sections 88-59 and 88-324, Hawaii Revised Statutes to establish deadlines for: (1) new members of the Contributory and Hybrid plans of the Employees' Retirement System to claim membership service credit for previous service and for previous military service; and (2) for members to initiate payment for previous service, previous military service, and unpaid leave, and to provide for an actuarially neutral cost for the acquisition of service.

The acquisition of previous or military service by Contributory and Hybrid members of the ERS is voluntary and currently may be claimed and purchased at any time during the employee's employment. This additional service credit will increase the employee's retirement pension, and at times will also allow the employee to retire earlier than their expected retirement date. Although earned membership service is supported by employee and employer contributions for the duration of a member's employment, acquired service is not. Previously forfeited service may be acquired by the Contributory member at any time during the employee's employment at a cost based on the employee's salary at the time of purchase. Previous military service may be acquired at any time after service eligibility requirements are met, and is also based on the employee's salary at the time of purchase. This amount is significantly lower than the actuarial cost which would be calculated based on the employee's age, retirement eligibility and projected retirement benefits over time. Furthermore, when an employee elects to pay for the purchase of service just prior to retirement, the system does not receive the investment returns that the system would have received had the payments been made earlier. As a result, payments that are insufficient to cover the actual cost of the increased benefits and that do not allow the system to realize investment returns over time to defray the cost of the increased benefits are borne by the employers and current and future members of the Employees' Retirement System.

The ERS actuary estimated that, if 5% of the retirees in the past year had purchased service under the proposed requirements rather than under our current statutes, the System's pension liability for the year would have been reduced by between \$3.5 million to \$5.5 million.

The proposed amendments will require that the member claim for previous service or military service within one year of enrollment or eligibility. After June 30, 2020, the cost to purchase membership service will be based on an actuarially neutral cost. The delayed implementation date will allow the system to obtain confirmation from the Internal Revenue Service that the change in the purchase price amount for acquiring previous service and military service will not be considered a change to the employer pick up plan previously approved by the Internal Revenue Service.

Thank you for allowing me to testify on this important legislation.